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May 21, 1998

Ray T. Williamson
Acting Director, Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85004

Re: Your memorandum of May 19, 1998 enclosing a copy of ACC Staff's position on some important issues related to retail electric competition; comments of the Arizona Transmission Dependent Utility Group

Dear Mr. Williamson:

You have asked for comments on this new draft staff position by noon on Friday, May 22, 1998. I represent the Arizona Transmission Dependent Utility Group, an intervenor in the stranded cost proceeding that has just concluded with the issuance of the Proposed Opinion and Order by Chief Hearing Officer Jerry Rudibaugh. We have also been a participant in the rulemaking proceeding generally.

I must say as a threshold matter that giving people some 36 hours to react to what you label as "important issues" erodes the credibility of the process. If the Commission and/or the staff is truly interested in receiving meaningful comment from "stakeholders", then adequate time to do so seems imperative.

Your notice also indicates that there will be a special open meeting of the Commission on June 3rd. Your memorandum does not say whether that will be confined to discussion among the Commissioners and staff about the proposal you finally docket with the Commission next Friday. Is the Commission planning to receive additional comment from "stakeholders" at that special meeting? Will comments be received only from those who participated in the stranded cost hearing process? Will

comments be received from anyone listed as a stakeholder in the rulemaking? Will written comments be accepted? Required?

As you can see from the above questions, your memorandum of May 19th raises many procedural issues. The draft statement of position of the ACC staff raises even more substantive issues. I will attempt to address some of them.

STRANDED COST

The current rules do not define the concept of "verifiable" in the definition of stranded cost. If divestiture occurs, the transaction in question will be evidence of the cost issues involved and constitute verification. If some other method is used, the concept of verification is left undefined. The portion of the definition related to a cut-off date for investment is omitted from your quotation and thus begs the question as to whether a cut-off date for stranded costs is still an operating mechanism. This in turn affects the concept of verifiability.

Unlike the Proposed Opinion and Order, you leave to the Commission appropriate recovery mechanisms and recovery periods. If recovery mechanisms aren't defined in the rules and recovery periods aren't specified, how will a utility present a case? How will opponents present rebuttal evidence?

You've acknowledged that the utilities have a burden of supporting their claims for stranded costs. However, you have not identified the standard for that burden of proof. You must have a standard in order to have a workable process. I would suggest that you must propose that the utilities must submit competent evidence so as to demonstrate by clear and convincing evidence that stranded costs have actually been incurred and the amounts incurred. Without a specific yardstick, no one will know the nature of the evidentiary burden on the utility or the nature of the necessary rebuttal evidence to overcome the proof offered by the utility. In short, you won't have workable rules.

You must differentiate between contract extensions and contract renegotiations. Otherwise, you don't have a workable concept for dealing with special contract customers.

You must specify a process and a methodology for the Commission determination of value related to assets transferred. Otherwise, the concept of "fair and reasonable" cannot be implemented.

AFFILIATE RULES

Here again, the decision-making contemplated is not defined as to process or methodology. This includes costs associated with the restructuring and costs approved by the Commission that are cost-sharing items or joint marketing programs.

IMPLEMENTATION OF COMPETITION

Your concept of timing and customer selection means that only small electric users will not have access to competition next January. You allow aggregation of loads of 20 kilowatts or more but at the same time have a separate staged-in access rule for residential aggregation. Is it your intention not to allow residences that have loads of 20 kilowatts or more to aggregate next January?

METERING AND BILLING

You allow competitive metering and billing services to begin next January for every customer that has access to competitive electric power services at that time. That is all customers at or above 1 megawatt of load and all customers at or above 20 kilowatts who can find a group with which to aggregate to meet the 1 megawatt threshold. This assumes that all new entrants can be licensed by January in order to join the affected utilities or their agents in offering such services. By the way, agents are not defined but I am assuming they would also have to be licensed.

You allow customers accessing competitive electric power services to choose who will send them bills. At the same time, you give affected utilities the power to order connections, disconnections and reconnections. It is not clear that they must do so at the customer's request. That must obviously be your intent or you would be strangling the system by allowing the affected utility not to comply.

LOCAL DISTRIBUTION COMPANY SERVICES

You designate affected utilities as providers of last resort and allow them to recover such costs through a distribution system-wide tariff approved by the Commission. This concept has not been intended to protect customers who do not pay their bills. It has been intended to protect customers from electricity suppliers actions over which they have no control. If the Commission does its job in licensing electricity suppliers, then extra charges for carrying reserves to supply to customers that need to reenter the system should be virtually nonexistent. Even if such events occur, why should not the person seeking the advantages of competition bear the risk that a bad choice was made? Why should someone pleading to come back to a system have a subsidy for doing so charged to other customers who didn't leave?

TRANSMISSION AND DISPATCH

There is no way you can order affected utilities to join an independent system operator. This concept, devised by the Federal Energy Regulatory Commission, is likely to fail in the Western United States. The Northwest ISO (IndeGO) has already collapsed. Desert STAR is being discussed but its own internal target is only to have a filing made at FERC by the end of this year. And there is no guarantee that Desert STAR will work.

Indeed, the ISO concept in the West has been thrown a curve by none other than the Internal Revenue Service in its temporary regulations on Private Activity Bonds. There is a substantial question about whether a multi-state ISO can be created under those regulations and whether a federal agency, here the Western Area Power Administration, can participate if such an entity is created. Since the system of the Western Area Power Administration and the system of those utilities that are capable of using tax-exempt financing are effectively intertwined with the systems of other utilities in this region, the IRS may have, at least temporarily, derailed the entire concept of ISO's in the West where, like Arizona, such conditions exist.

For the same reason, the temporary use of an independent scheduling administrator may not work. Depending on the level

of control that such an entity is given and the type of entity involved, the same concerns raised by the IRS rules may pertain. Since there is no current discussion about how to put together an independent scheduling administrator, and all current efforts are invested in the development of the ISO, Desert STAR, putting an independent scheduling administrator process in place by January 1 would seem problematic, even if not impeded by IRS regulations. Moreover, the decision with regard to must-run units in a multi-state context cannot be made only by the Arizona Corporation Commission.

I have presented these questions and issues by way of example. They are hardly inclusive. I am also enclosing as an attachment the comments of K.R. Saline, our witness in the stranded cost proceeding. If we, being essentially outside the ACC process, can think of this many concerns, I rather imagine that the affected utilities have even longer lists. I have not attempted to discuss the differences between the Proposed Opinion and Order and this document, let alone differences between H.B.2663 and this document. Suffice it to say that the Commission has an enormous task in front of it if the Commission is choosing to articulate a different playing field than the one described for Salt River Project in H.B.2663.

Since you did not indicate that this document constitutes any part of the rulemaking docket at this time, I will presume that I am not obligated to copy the other parties to that proceeding. If I am in error in that assumption, please let me know.

Sincerely,

Robert S. Lynch

RSL:psr
cc: Docket Control Division
Jerry Rudibaugh
Paul Bullis
Arizona Transmission Dependent Utility Group

Detailed Comments on ACC Staff Position by K.R. Saline, K.R. Saline & Associates:

A: Stranded Costs:

The Staff should add the position that all new loads added after 12/26/96 shall not be subject to paying for any stranded costs.

As the staff correctly recognized in its position on Special Contracts, the utility should be at risk for all costs and decisions made to connect new loads after 12/26/96. This position will also ensure that over recovery of stranded costs by the utility does not occur. For example, if a utility added 100,000 new customers between 12/26/96 and 12/31/98 then the utility has been recovering additional capital recovery over that period of time to above costs which where already recovered in rates. This over recovery has reduced the amount of stranded costs which could be assessed to the existing customers. To allow assessment of stranded costs on the new loads would guarantee double recovery by the utility, because the current rates have not been adjusted for load growth. If this provision is not implemented, then all new loads must avoid standard offer service to avoid paying for stranded costs assessed to standard offer customers prior to 1/1/99. This will create an unfair burden to the new customer and eliminates the benefits to existing customers of adding new standard offer customers who can help dilute any potential stranded costs of the utility (i.e. load growth will help mitigate stranded costs).

Furthermore, as prospective new loads are added, the ability for the residential customers to ultimately achieve access after 1/1/01 will be based upon successful residential aggregation programs being developed and implemented in the interim. Allowing all new loads after 12/26/96 to avoid stranded costs will encourage the developers and new communities to develop residential programs so a robust residential access program will be operating as the remainder of the residential customers are able to participate. This will help avoid the California syndrome, where very few customers are participating and residential access is tremendously lagging the larger loads.

B. Affiliate Rules

The paragraph "The Affected Utility must offer the same terms and conditions of service to all competitors and their customers as it offers to any of its affiliates and their customers." is mandatory for nondiscriminatory retail access to occur. Furthermore, exertion of market power situations or anti-trust actions should not be tolerated and should be well documented in the ACC rules so all customers are afforded prompt and definitive legal remedies should such anti-competitive actions occur. The goals of the ACC should be amended to state that affiliate rules will be developed:

* **to eliminate anti-competitive or discriminatory actions by affiliated utilities**

An example of this goal is the implementation of transmission rights. While distribution wire services will be comparable from load to load, the transmission rights on the grid will determine whether the loads or the generators have transmission rights on the system. The staff must remember that the Arizona system is like a wagon wheel with the load in the hub and the generators and markets around the rim.

If the generators have the transmission rights, then they will use the rim to reach to the highest value market (i.e. California) to maximize revenues. If the loads have the transmission rights, then the loads will have access to four-corners, Marketplace and Palo Verde, three of the most competitive trading locations in the southwest. Clearly, the loads must have the transmission rights on the system for retail access to be successful in Arizona.

The system was developed to connect the hub and wheel and only excess transmission should be utilized for through-wheeling to other load centers. The FERC clearly recognizes native load rights to the transmission system. If the utilities are divested, the native load transmissions rights must be transferred from the Merchant (i.e. generation) group to the loads. The loads have paid to develop the system and the full repayment of the transmission system is included in the current rates. Unlike generation assets, transmission assets are fully recovered.

As loads are aggregated, or switch service providers, their transmission rights will also be very important in delivering multiple resources and achieving economies of scale among consumers for using transmission resources and ancillary services. Without the ability for each customer to have and transfer their transmission rights, the loads will be always be subject to being on the margin for switching service or be subjected a single geographic supplier with limited flexibility for resource optimization or efficiency. By providing a clear direction that transmission rights must stay with the loads, the loads (i.e. customers) will be assured of access to a robust market of suppliers without penalty for switching suppliers, which will in turn make retail access very successful in Arizona.

Without this direction, the generation affiliate will attempt to assert ownership rights to the transmission system thereby subjecting the consumers to a bidding regime for transmission rights as well as generation suppliers. If the generation affiliates end up with the transmission rights, the generation affiliate will end up with all of the tools (i.e. deregulation and transmission rights) to be financially successful and control the market. This will of course lead to market power domination by the transmission owning companies power affiliate in the region. This is a critical issue which must recognized and addressed head-on by the ACC staff.

C. Implementation of Competition

As mentioned above, the effective implementation of competition must include transmission rights to the loads and eliminate stranded costs for new loads added after 12/26/96.

The staff should also consider the mathematics of its proposal and self imposed limitations on customer participation. If an affected utility has 4000 MW of peak load then with the 1 MW limits, in the worst case the utility could end up no more than 4000 customers as long as the ACC Staff does not impose a limit on each customer for participating. Assuming the customers are aggregated, the aggregated size limitations will be applied to scheduling and delivery requirements at the generation and transmission level, not at the individual meters. So it doesn't' really matter to an aggregated pool if the aggregation has 50 - 20 kW customers or 1000 - 1 kW customers, as long as the aggregated pool operates with the ISA and transmission operators on a comparable basis. By reducing the customer limitations early on, the ability to include the small customers will lead to a more cross-sectional and efficient aggregation

throughout the phase in period. While the economics of separately managing a 1 kW load may be the real limiting factor, the ACC Staff should not impose a 20 kW standard on the customer which is not the real factor which determines a customer's ability to participate.

D. Metering and Billing

We suggest the ACC Staff add the goal of:

* **To promote the economic transition of existing metering to new metering technologies.**

While the new metering costs are not necessarily unaffordable, if there are 1 million meters in the valley at $100 per meter the consumers will ultimately bear $100 million of new costs and leave potentially functional meters stranded from providing any further service. The major applications for new metering will be for the large customers who choose to dynamically meter their loads and schedule their resources to avoid energy imbalance charges. If a customer cannot economically justify the cost of a new meter through reduced energy imbalance charges or reduced meter reading charges, then the customer should be permitted to continue using the existing technology and load profile their consumption with any supplier. If, over time, the energy imbalance, metering, and billing charges are competitive such that the customer can justify buying a more expensive or sophisticated meter then such changes will progress in orderly fashion. Competitive metering companies can obviously provide another incentive to the smaller customer to change metering services, (i.e. provide a free meter for changing their metering company).

We strongly support the concept of load profiling being acceptable as open access metering but recommend the 20 kW limitation and "after the transition period" be removed. There are loads and customers who may have load profiles which are very compatible with load profiling irregardless of the size of the load. For example an irrigation pump is usually much larger than 20kW, but it uses the same amount of electricity every hour that it operates and has a very predictable load shape. If the customer can reasonably predict their operation, they can predict their usage and demonstrate their load profile is accurate for their end-use load type.

Similarly, it has been implied in discussions that only the standard offer customer class can use load profiling for their loads. This is anti-competitive and represents another misrepresentation of the physical facts of the customer. If a customer's load can be load profiled for estimating their load for APS to schedule and deliver power, then there is absolutely no physical reason why the load cannot be profiled and used by another entity to schedule and deliver resources.

E. Local Distribution Company Services

The goals of the ACC for Local Distribution Company Services should be that the Affected Utility will provide comparable distribution wire services to all customers and offer Standard Offer service to all customers who do not choose to change suppliers. The first part of this goal clearly delineates the comparability standard for providing wire services to all

customers irregardless of their supplier. This goal or standard will also make sure every consumer is aware that their changing of power supplier will not permit a change in the quality of service afforded the customer. Linking comparability in the section of Local Distribution Company Services reinforces wire service comparability.

F. Transmission and Dispatch

As mentioned above, the firm transmission rights must be associated with the loads. In addition, since the entire transmission and dispatch system is changing to an unbundled and independent service, we suggest the Staff change the paragraph stating that ISA costs will be recovered from competitive customers to recovered from all Scheduling Agents on behalf of all customers. Even though initially, the ISA's purpose will be to include additional suppliers, the affiliated merchant groups should also have to pay ISA' costs upon implementation dates. Another means would be to charge each ISA the same unit cost/kw or cost/customer which is imbedded in their standard offer rates. This way ISA costs will be borne fairly by all scheduling agents which use the ISA services including the merchant groups which serve the standard offer customers. Otherwise, the ISA charge will become another barrier to retail access since the entire ISA costs will be driven by the incumbent control areas and collected by only the competitive customers. There would be too many incentives in the current proposal to increase costs to deter consumers from switching to competitive suppliers.

Finally, with regard to the ISA/ISO issue, the ACC should recognize that there are major problems with the ISO at the IRS and among the transmission owners that are yet to be resolved. The ACC should not mandate an ISO but allow the ISA to evolve if retail access is to begin on schedule. The ACC should allow the ISA process to work then intercede if market power conditions mandate that the separation mandated by FERC under Orders 888 and 889 are not sufficient to force open and comparable transmission access. If the ISA process achieves affordable and comparable retail access, then the ISO may or may not be needed. Evolution and patience should be exhibited in this process since the reliability of the system is a significant issue which should be addressed carefully.